



ONE NORTH SAN ANTONIO ROAD
LOS ALTOS, CALIFORNIA 94022-3087

December 11, 2013

**Honorable Members of the City Council
City of Los Altos, California**

We are pleased to present the Comprehensive Annual Financial Report (CAFR) of the City of Los Altos, California (the City) for the fiscal year ended June 30, 2013 along with the Independent Auditors' Report. The CAFR was prepared by the City's Finance Department and the information contained therein is based on a comprehensive framework of internal control established for this purpose. The objective is to provide reasonable assurance that the financial statements are free of material misstatements. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the City. We believe that the information, as presented, is accurate in all material respects, that the presentation fairly shows the financial position and the results of the City's operations as measured by the financial activity of its various funds, and that the included disclosures will provide the reader with an understanding of the City's financial affairs.

This letter of transmittal is designed to complement the Management's Discussion and Analysis (MDA) section of the CAFR and should be read in conjunction with it. The MDA provides a narrative introduction, overview and analysis of the Basic Financial Statements, and can be found immediately following the report of the independent auditors.

PROFILE OF THE CITY AND ITS SERVICES

Tree-lined streets and a small village atmosphere characterize Los Altos, which is located in the heart of world famous Silicon Valley. Just 40 miles south of San Francisco, Los Altos is a residential community with a population of approximately 29,000 served by seven small retail areas. The seven square mile residential city is developed with small businesses, schools, libraries and churches. Incorporated on December 1, 1952, Los Altos is a general law city operating under the Council-Manager form of government. There are five Council members elected at-large, serving four-year overlapping terms. Municipal services provided include police, streets, facilities and parks maintenance, engineering, community development, recreation, solid waste and sewer. Fire protection is provided through a contract with the Santa Clara County Fire Department.

SERVICE EFFORTS AND MAJOR INITIATIVES

Service Efforts and Budget Compliance

The City continues to provide a high level of service to its residents and citizens through multi-year financial planning. Budget limits were met with the General Fund reporting a strong operating surplus indicative of the prudent fiscal measures Los Altos has put in place and diligently followed since the economic downturn. The fiscal results this year have favorably delivered on this careful planning and forward-looking process. Contingency reserves have again been strengthened, capital improvements funded and budget projections met. Final pension liability pay downs were acted upon per the fiscal strategy set forth by Council. This year of reporting reveals significant development tax and fee collections, funds which have been recorded within the City's capital project funds. All major funds performed as expected and reflect continued cost-saving efforts during these times of economic recovery.

Major Initiatives

Capital Improvements: FY 2012/13 marked yet another year of capital re-investment into the community with substantial resources applied to City-wide improvements. Some larger dollar capital expenditures, applied to both ongoing and/or completed projects, of note this year include:

San Antonio Road Sidewalk	\$ 1,189,460
Annual Street Resurfacing	702,470
Sewer Collection System Upgrade	544,510
First Street Phase 1B	536,520
Annual Sewer Main Repairs	303,020
Homestead Road Safety Improvements	291,990
NPDES Compliance	224,430
South Sewer Main Replacement	174,810
Annual Sewer Root Foaming	166,410
Downtown Parking Management Plan	157,280
Tri-City Safety Public Safety Virtual Consolidation	154,540
Annual ADA Accessibility	154,230
Fallen Leaf Lane Sewer Main Replacement	128,860
In Pavement Crosswalk Lighting Systems	115,820
Annual Concrete Repair	133,030
Sewer Collection System Upgrade	67,230
KMVT Increased Public Broadcasting Capital	65,000
ADA Transition Plan	60,500
Annual Street Striping	59,910
Sewer Main Replacement Phase II	55,970
Climate Action Plan	55,970
First Street Streetscape Design	50,320
IT Initiatives	38,970

Pedestrian Safety, Roads and Walkways: Los Altos is noteworthy for investing substantial resources on a variety of roadway, pedestrian and bikeway initiatives and improvements. Over \$1 million was applied to street resurfacing, sidewalk repairs and street lighting systems and bicycle transportation updates, enhanced safety lighting, street striping, signage and Americans with Disabilities Act enhancements. These efforts support the City's high roadway condition index while increasing overall pedestrian, bicycle and vehicular safety.

Ongoing Downtown Revitalization: Revitalization of the downtown corridor continues with great emphasis placed on the rehabilitation of San Antonio Road and completion of street/intersection improvements. Current and recent year dollars spent on First Street improvements have facilitated the private developments noted below and in the prior year report. Phase IB, an extension of last year's First Street improvements made, is progressing towards completion. These projects will result in the complete renovation of the First and Main Streets intersection, installation of new signals, core sidewalk and lighting improvements. These upgrades are intended to have a positive impact on the core downtown area and enhance the overall pedestrian experience.

Noteworthy Private Developments: Significant private development progress was made again this year with several key First Street groundbreakings, including a new marquis Safeway store, 48 luxury townhomes, and an office/retail development at First and Main Streets. A major residential/retail development at the site of the former Los Altos Garden Supply and Marie Callender's site adjacent to the El Camino business district is also underway. These endeavors underscore the strategic posture the City has taken in supporting economic development efforts. This year also saw the completion of 20 new townhomes on south First Street. Private investment dollars in the tens of millions have been introduced into the downtown equation.

Enhanced Safety Technology: Expenditures continue to be applied to the Safety Tri-City Interoperability project. This important regional project will enhance the public safety data and radio communications systems, with a focus on multi-city interoperability and strategic planning. It promotes shared technology systems that will enrich the abilities of the Los Altos, and surrounding public safety agencies, to communicate with each other in both routine and emergency situations. This project allows for sharing of information that will assist the regional enactment of safety duties. Nearly \$500,000 has been expended inception to date, with this project continuing through FY 2013/14.

Homestead Roadway Improvements: Nearly \$300,000 has been expended on the improvement of streetscape, pathway and road improvements on Homestead Road in south Los Altos. This capital improvement is intended to promote pedestrian and bicycle safety, beautify medians and develop vehicular circulation efficiency on this important roadway.

Sewer System Improvements: A fully studied and revamped Sewer Master Plan was completed and adopted by City Council this past year as an important step to ensuring the long-term viability of this vital infrastructure. In the current year alone, the City invested nearly \$1 million in system improvements and key maintenance measures at a variety of City locations. As the new master plan progresses into the future, it will provide a roadmap to fortifying high priority line replacements and system installations.

FINANCIAL CONTROLS AND PROCEDURES

Financial Policies and Standards: The City has followed a fiscally conservative philosophy of building and maintaining healthy financial reserves. This has allowed the City to sustain quality services to its residents in a time when many local agencies have been forced to cut back due to fiscal constraints. On an annual basis, the Council approves financial policies designed to promote sound financial management and ensure fiscal integrity. This CAFR reflects implementation of these financial guidelines and presents all fund reserves and assignments that define fund balance commitments and obligations as of the financial report date. Such policies have been updated to encompass the recent requirements of GASB 54.

Internal Control Structure: City management is responsible for establishing and maintaining fiscal internal controls important in safeguarding the assets of the government from loss, theft or misuse, and to ensure that accounting data is accurately compiled in accordance with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of controls should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits require estimates and judgments by management. Adopted administrative purchasing policies were updated in June 2012 and provide a significant attribute to the internal control model.

Cash Management Policies: It is the City's practice to "pool" available cash from all funds for investment purposes. In accordance with the annually adopted investment policy, available cash is invested with the goal of safety, meaning protection of principal, as the first priority, ensuring adequate liquidity as the second priority and maximizing yield as the third priority. This past year continued to display historic lows in interest rates with a drop in LAIF earnings rates below one half of 1%. This condition was, and is, expected to persist. Staff acted on the Council's plan to engage investment advisory services and have diversified the City's investment portfolio as a means of mitigating the impact of interest rate swings. As always, the emphasis remains on preserving the safety of principal.

Strengthening Key Fund Reserves: This financial report reflects the attainment of judicious fiscal reserves noting increases in both capital and economic safety fund balances. As projected in the budget process, the results herein place the City in a position to maintain its 20% General Fund reserve goal – a goal reached a year in advance of the projected plan.

Risk Management: The City has long been insured for general liability through a Joint Powers authority (JPA) that covers claims in an amount up to \$10 million with a deductible or uninsured liability of up to \$100,000 per claim. The City is self-insured for Workers' Compensation and has an excess insurance policy for such claims up to the statutory limits. The deductible for Workers' Compensation is set at \$250,000 to mitigate risk losses. In the current year, the City transferred its general liability insurance coverage to the Bay Cities Joint Powers Insurance Authority as a measure to enhance and strengthen coverage. The City updated its actuarial valuations in FY 2012/13 resulting in a notable increase in workers' compensation and general liability obligations. Although the City maintains adequate funding levels, these rising cost challenge areas need continued attention.

GASB 45 Compliance: This report complies with the provisions of Government Accounting Standard Board Statement #45 (GASB 45). This standard pertains to Other Post Employee Benefits (OPEB) and requires the completion of an actuarial study to quantify and account for related liabilities. This recent reporting requirement is described in financial note 12 of the CAFR and the related liabilities reflected in the statements. As of June 30, 2013, the City's net OPEB obligation was valued at \$994,000, an amount reflected in the government-wide statements. Long-term unfunded liabilities equal \$2.1 million. Over the past three budget cycles, the City has earmarked and set aside \$500,000 in reserves to address this liability funding. Over the course of the next year, a variety of funding options available to the City will be evaluated. In the interim, these costs will be accounted for on a pay-as-you-go basis and included into future budgets.

EXECUTIVE FINANCIAL OVERVIEW

This executive financial overview is presented as a supplement to the more detailed and comprehensive analysis presented in the MDA. This section highlights key financial performance indicators for our major funds.

General Fund

The General Fund, the primary operating fund of the City, performed extremely well realizing operating revenues over expenditures of \$3.1 million, more than double achieved in the prior year. This results from a planned commitment to cautious financial planning, conservative budget estimates and dedicated departmental stewardship. This year is also distinguished to the extent that key revenue trends have reflected a notable and long-awaited uptick. At year end, the total General Fund balance equaled \$8.5 million with an unassigned fund balance of \$2.4 million after commitments and assignments of \$6.1 million. As planned for in the budget process, a portion of this surplus margin has been allocated to funding capital improvements, increasing existing economic reserves and further funding Other Post-Employment Benefits (OPEB) as directed per Council's discretion.

Considering the transfer and use of reserve activity listed below, most notably \$700,000 for future capital commitments and \$950,000 to further pay-down CalPERS side fund liabilities, the final General Fund balance still increases by \$1 million. This non-operating and transfer activity is summarized as follows:

- \$950,000 to further pay-down the CalPERS side-fund liabilities
- \$565,000 transfer out of operating surplus reserves to the Capital Projects Fund
- \$232,000 transfer out to fund Storm Drain Fund activities
- \$200,000 transfer out to seed future equipment replacements
- \$190,000 transfer in from the Gas Tax Fund for supporting engineering operations
- \$165,000 transfer out for general debt service payments
- \$75,000 transfer in from public safety grant funds
- \$20,000 transfer in from safety vehicle impound fees

The recovery of the General Fund revenue stream has seemingly displayed a bit of “light at the end of the tunnel,” a condition that will be watched closely given the uncertainty that still lingers in the national and state economy. This current-year turnaround in Property tax trends is encouraging with 2013 realizing 6% gains in contrast to a small to no increases in recent years. Moderate growth is expected in line with regional forecasts. A table of year-to-year comparisons of key General Fund revenues follows:

<i>Revenue (millions)</i>	<i>2012 Actual</i>	<i>2013 Actual</i>	<i>Variance \$</i>	<i>Variance %</i>
<i>Property Tax</i>	\$13.30	\$14.13	0.83	6.23%
<i>Sales Tax</i>	2.75	2.93	0.18	6.56%
<i>Hotel Tax</i>	1.78	1.95	0.16	9.23%
<i>Utility Users Tax</i>	2.55	2.60	0.05	2.05%
<i>Other Taxes</i>	0.91	1.12	0.21	23.22%
<i>Franchise Fees</i>	1.73	1.77	0.04	2.21%
<i>Interest</i>	0.07	0.08	0.01	14.23%
<i>Recreation</i>	1.81	1.86	0.06	3.16%
<i>License and Permits</i>	2.51	3.24	0.72	28.72%
<i>Other</i>	1.49	1.60	0.10	7.00%
Total	\$28.91	\$31.28	2.37	8.19%

General Fund revenues have increased robustly by 8% versus a 1% in the prior year. Revenues came in at 105% of annual budget estimates with property tax, sales tax, hotel tax, franchise fees and recreation service fees being the front runners. Property tax, the City’s mainstay, strongly rebounded from the prior year and sets a positive tone for future budget planning. Sales tax came in again for a second year at a 6% gain coming off of double-digit drops three years ago. Tourism continues its recovery as indicated by the hotel tax gains of over 9% following a 17% increase last year. Interest income continues to fall and gains in this area will be modest at best as the federal government navigates a new Federal Reserve chair and its easing strategy. Utility users and Real Estate transfer tax performed well coming in over budget estimates. License and permit fees championed the year with nearly 30% increases - a clear indication of vigorous development activity, much of which cannot be expected to repeat itself. Residential remodel and rebuilding activity maintains a strong pace. Recreation programs generated revenues of 3% above last year banner levels. Franchise Fees were within budget. It is quite extraordinary that all major general revenue sources display year-to-year gains.

General Fund expenditures came in 6% below budget contributing to the net surplus mentioned above. These savings primarily result from temporarily deferring the filling of additional authorized positions in 2012/13 and continued budget management diligence at the department level. Compared to last year, expenses increased by \$680K or 2.4% mostly driven by labor, benefits and professional service costs.

Even with the welcome signs of strength noted above, the City’s revenue base remains in a delicate environment and the City remains cognizant of rising costs in the areas of pension rates, insurance, capital funding and deferred facility maintenance. As such, the City’s commitment to maintaining prudent, proactive and conservative fiscal planning is important.

Other Funds

Capital Project Funds: The Capital Projects Fund was very active, with expenditure levels reaching \$4 million, ending the year with a total Fund balance of \$4.8 million. The remaining \$1.7 million of this fund balance will be applied to the funding of future projects as identified in the City's five-year Capital Improvement Program. Long-term forecasts again underscore the need to identify specific dedicated capital project funding sources as a means of eliminating this Fund's reliance on General Fund residual transfers.

The Community Facility Renewal Fund, a capital fund designed to support City-wide facility improvements reports a balance of \$7.2 million. The Real Property Proceeds Fund ended the year with a balance of \$7.4 million with additional deposits made on the sale of property at 400 Main Street. Given the significant private developments in Los Altos, the Traffic Impact and Park in-Lieu Funds have grown substantially with balances of \$1.4M and \$4.6M respectively. Lastly, the Equipment Replacement Fund finished the year with a balance of \$3.7 million, a moderate drop from prior year levels.

Special Revenue, Internal and Enterprise Funds: All other Governmental and Business Type funds performed as expected. Non-major special revenue funds ended the year with a combined balance of \$3.9 million while Enterprise funds ended the year with combined net asset balances of \$13.5 million.

Trust and Agency Funds: The City acts as a custodian of funds held for the benefit of others including the administration of the North County Library Authority. The long-standing Raymundo and Avalon curb and gutter special assessment districts are classified to the trust and agency group in recognition of the limited nature of this debt which is fully collateralized by homeowner assessments without City obligation. The Blue Oak Lane Sewer special assessment district is similarly treated.

ECONOMIC TRENDS

Recent forecast have indicated that the State is "on the road to normalcy" albeit under a new definition of normal trends. The economy is expected to be notably better off than what has been experienced in past recent years with moderate but stable growth expected into 2013/14. GDP in the 3% ranges are expected for the next two years in contrast to the 2% growth numbers touted this time last year. As we navigate the two-year FY 2013/15 budget cycles, we would be remiss not to stay observant of the financial threats that face local municipalities. We remain watchful of easing housing and credit pressures, the reparation of the California State budget, state and national pension reform initiatives, rising insurance costs and the implementation of a revamped healthcare model.

INDEPENDENT AUDIT

The public accounting firm of Burr Pilger Mayer (BPM) was selected last year as a new firm to perform the annual independent audit as part of the City's rotation practice. Their second year auditors' report on the City's financial statements is included in the financial section of this report.

AWARDS

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City for its CAFR for the fiscal year ended June 30, 2012. This was the seventh consecutive year that the City has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized CAFR. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

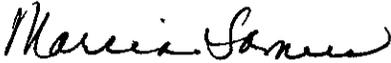
A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the Certificate of Achievement Program's requirements and are submitting it to the GFOA to determine its eligibility for another certificate.

ACKNOWLEDGEMENTS

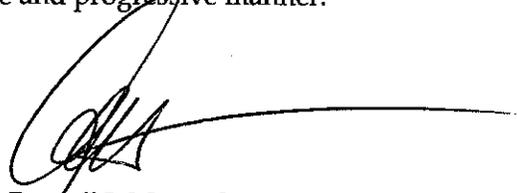
Preparation of this report could not have been accomplished without the efficient and dedicated services of the Finance Department staff, notably Sarina Revillar and Courtney Makishima. We would like to express our appreciation to all members of the department who contributed in any part to the final product. We also want to thank Burr Pilger Mayer (BPM), our independent auditors, for their high level of service and professionalism in performing this year-end financial audit.

In closing, the continued leadership and support of the City Council enabled the staff to conduct the financial operations of the City in a responsible and progressive manner.

Respectfully submitted,



Marcia Somers
City Manager



Russell J. Morreale
Finance Director